

Chapter 4

Drafting the Arbitration Agreement

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§ 4:1 Introduction

The arbitration clause is usually part of a contract. In important business and commercial transactions, the contract may be elaborate and complex. The arbitration clause and related clauses will usually be addressed near the end of the contract negotiation. Their application will turn on future events; they do not have the immediacy that other provisions may have.

Nevertheless, if the contract runs into difficulty and disputes arise, the arbitration clause and related clauses may be the most significant clauses in the contract. They should be negotiated as thoroughly and intelligently as any important section of that document.

§ 4:2 Initial Questions

The first question that the corporate advisor should face is “How should disputes that arise be resolved?” In chapter 1, that question was surveyed and a decision should have been made long before the drafting of the contract was completed as to the preferred method of dispute resolution. If the decision was to arbitrate, consideration of what the arbitration clause should contain should have been well under way before the time to negotiate the arbitration clause was reached.

A second question derives from the first: If the decision is to arbitrate, should any preliminary steps be required before arbitration? Most disputes between corporations are resolved by informal discussions among the corporate personnel most conversant with the subject matter from which the dispute derives. Only when their informal attempt to resolve the matter fails, do the parties consider moving on to some other resolution method—usually some form of negotiation directly or with the assistance of a neutral participant (mediation). If mediation fails, the parties will turn to binding procedures and the choice will be between arbitration and litigation. Sometime the contract will provide for mediation before arbitration.

In some circumstances, particularly in contracts between enterprises and governmental or public entities, a third question arises: Is the governmental or public entity entitled, under the law applying to it, to enter into agreements to arbitrate? There may well be legal rules applying to such entities requiring them to resolve their disputes in a particular manner and those rules

may deny them the legal capacity to enter into an arbitration agreement.

After these initial questions have been considered, the arbitration clause should be prepared.

§ 4:3 Checklists

In planning for the arbitration clause, the following enumerated elements should be considered.

§ 4:3.1 Checklist for Domestic Arbitrations

1. What should be the scope of the arbitration clause?
2. Should it include an entry of judgment provision?
3. What institution or set of rules should be selected?
4. What venue should be selected?
5. What substantive law should be chosen?
6. Should the tribunal consist of one or three arbitrators?
7. How should the tribunal be chosen?
8. Are interim measures likely to be required?

§ 4:3.2 Checklist for International Arbitrations

This list should contain the same elements as the Domestic List. It should also contain two additional elements:

1. What will be the language of the arbitration?
2. What is the most desirable international venue?¹

1. In a domestic arbitration, involving interstate or foreign commerce, the successful party will ordinarily rely upon the Federal Arbitration Act for enforcement. In an international arbitration, the successful party will ordinarily rely upon the New York Convention of 1958.

§ 4:4 Domestic Arbitrations

The eight elements of the domestic arbitration checklist raise important and interesting problems that are considered *ad seriatim* below.

§ 4:4.1 Scope of the Arbitration Clause

The jurisdiction of an arbitral tribunal is derived from the consent of the parties. Unlike courts, arbitral tribunals do not have any general jurisdiction. Their jurisdiction to adjudicate is found in and delimited by the arbitration clause. Numerous arbitration clauses have been cited in chapter 3. All of them are what are called “broad” clauses and, as such, are generally broadly interpreted by courts. Great care should be taken in changing them in any manner and any change should be made only after a careful analysis of its pros and cons in terms of the specific objective that the change is designed to address. As a general rule, it is unwise to alter the wording of institutional arbitration clauses. Alterations may have the unintended consequence of changing the scope of the clause.

The question of the principles that should apply to the construction of the arbitration clause was considered in a 2007 House of Lords decision, *Premium Nafta Prods. Ltd. v. Fili Shipping Co.*² One issue before the court was whether there was any difference in substance between the phrases “arising under” and “arising out of” in the context of commercial arbitration clauses. Lord Hoffman, who wrote the leading opinion, found that the time had come to make a “fresh start” and to move away from decisions that found differences in the two formulations.

The Lords also stated the principles that should govern the construction of an international arbitration clause. The starting point should be the presumption that the parties, as rational business people, intended that all disputes arising out of the relationship they entered (or purported to enter) would be determined by the same tribunal. The Lords held that arbitration clauses should be construed in accordance with that presumption, unless the language of the contract made it clear that certain types of disputes were to be excluded from the arbitral tribunal’s jurisdiction.

2. *Premium Nafta Prods. Ltd. v. Fili Shipping Co.*, [2007] UKHL 40.

The *Premium Nafta* decision is important in two respects. First, it offers to the arbitration community a thoughtful formula upon which to base the construction of arbitration clauses. Second, it brings English law into alignment with the liberal approach to the construction of arbitration clauses that was already accepted quite widely in international commercial arbitrations.

§ 4:4.2 *Entry of Judgment Provision*

Section 9 of the Federal Arbitration Act provides:

If the parties in their agreement have agreed that a judgment of the court shall be entered upon the award made pursuant to the arbitration, and shall specify the court, then at any time within one year after the award is made any party to the arbitration may apply to the court so specified for an order confirming the award. . . .

A provision for entry of judgment may be useful and should be included in a domestic arbitration clause. Some institutional sets of rules contain the required language, for example, the rules of the AAA and the CPR Domestic Rules. Generally, international rules do not contain such language, because enforcement of international awards turns on the New York Convention. If this language is needed, simply add: “Judgment upon the award may be entered by any court having jurisdiction thereof.”³

§ 4:4.3 *What Institution or Set of Rules Should Be Selected?*

This is a complex problem. The answer turns, in some measure at least, on the complexity of the case, the amount at issue, and the arbitral experience of the counsel who will conduct the case.⁴ Other considerations are the location and nationality of the potential other party. Also to be considered are any particular provisions of a set of rules that seem undesirable from the client’s point of view. For example, some rules exclude punitive damages, others do not; some rules contain specific provisions with respect

3. For a more detailed discussion, see section 7:8.

4. Because it is generally agreed that ad hoc arbitrations are not for beginners, we do not discuss them in this chapter.

to the lawyer-client privilege, others do not; and some rules provide for reasoned awards, others do not.

Of course, the parties can choose a set of rules and agree to eliminate or alter certain specific rules. It should be kept in mind, however, that some rules are not subject to change. The best examples are the “terms of reference” and “scrutiny” rules of the ICC. If the parties insisted that these rules be changed, the ICC would almost certainly refuse to function as the administrative body.

Sometimes parties incorporate into the arbitration clause time requirements designed to expedite the issuance of the final award. These requirements often prove to be unrealistic when the case is commenced and the tribunal has been selected. The parties can agree to change them, but if they do not agree, the arbitration must be tried and the award prepared under time constraints that may prevent a full presentation of the evidence and require the tribunal to produce its award without having had sufficient time to consider the issues fully. Hence, as a general rule such bespoke requirements should not be imposed on the ready-made rules.

No arbitration clause will fit all matters and solve all problems of commercial arbitration. Overly detailed clauses should be avoided, as should clauses that, for example, provide that the Federal Rules of Civil Procedure should apply to the arbitration. But there may be cases where the inclusion of unusual provisions is justified.

Another factor to consider is the cost of administration. All institutions state their administrative cost structure in their rules, and counsel can estimate such costs on the basis of the tables provided. Of the institutions considered here, the ICC is usually the most expensive and the CPR the least. However, since the ICC’s fee structure is based on the amount claimed, its fee for arbitration involving smaller claims may actually be the least expensive. Of all of the institutions, however, the ICC provides the most thorough and helpful administration.

§ 4:4.4 What Venue Should Be Selected?

This issue is less important in domestic arbitrations than in international arbitrations, but it cannot be ignored in either.⁵ Clearly counsel should select a venue that is convenient for both parties and has laws and courts that are not hostile to arbitration. In addition to the legal environment, counsel should also take into account the availability of facilities, ease of transportation, if travel will be involved, and other such logistical considerations. Within the United States, the preferred locations for arbitral venues are, in alphabetical order, California, Chicago, Florida, New York, Texas, and Washington, D.C.

However, in domestic arbitrations, California and Florida have a minor disadvantage in that there are certain requirements that an out-of-state attorney must meet to appear in arbitrations. In California, the out-of-state attorney must get the arbitrators' permission to appear, file a form with the California Bar, and pay a \$50 fee. There is no fixed numerical limit on how many times one can follow this procedure before he crosses the line into regularly practicing law in California.

In Florida, the out-of-state attorney must file a form with the Florida Bar and pay a \$250 fee. However, if one appears more than three times in a 365-day period, one is ineligible to appear as a non-Florida lawyer.

Neither California nor Florida applies these rules to international arbitrations.

States that have laws or court decisions unfavorable to arbitration should not be selected.

§ 4:4.5 What Substantive Law Should Be Chosen?

The substantive law (*lex causae*) is the law that governs the merits of a dispute (that is, in the case of a contract, the parties' substantive rights and obligations) as opposed to the law governing the procedure of the arbitration (the *lex arbitri* or *lex fori*). In important contracts, the law of a state with a substantial body of commercial law, for example, New York or California, is usually

5. It is less important in domestic arbitration because the Federal Arbitration Act applies to all states of the United States. However, not all nations are members of the New York Convention.

chosen as the substantive law. The choice of law provision should provide that the law of the entity selected is its “internal” law. This language excludes the conflict of law rules of the jurisdiction selected. If the choice of law clause merely selects “the law of New York,” it will probably be construed to include New York’s conflict of law rules. Those rules might select the laws of another jurisdiction, depending upon the “contacts” of the transaction outside New York. It should be clear that the clause is designed to select the rules that would apply to a matter having no contacts outside the jurisdiction selected. Choosing the “internal law” achieves this objective.

Often the substantive law is set forth in a governing law clause separate from the arbitration clause. It may be contained in the arbitration clause, so long as it is clear that the substantive law provision is independent from the other provisions of the arbitration clause and that they relate to the contract as a whole. In most cases, however, the better drafting would be to use two separate clauses.

§ 4:4.6 *Should the Tribunal Consist of One or Three Arbitrators?*

There is a rule of thumb that a sole arbitrator should be used only in matters involving \$100,000 or less; matters involving larger amounts should be heard by a tribunal of three. The principal advantage of a sole arbitrator is that one arbitrator costs less than three. Another advantage is that it is easier to schedule hearings if only one arbitrator is involved. On the other hand, parties often prefer three-person tribunals because, if each selects a party-appointed arbitrator, they have had an opportunity to exercise their individual judgment in selecting an arbitrator. In addition, if the party-appointed arbitrators are to select the chairman, they gain some participation in that selection.

Moreover, there are other important considerations. If the case involves matters that have an importance that is not measured by the amount of money at issue, for example, the interpretation of an important contract, or if the parties come from different legal systems, three arbitrators is usually the better choice. For arbitrations involving large financial stakes or the interpretation of important contracts or statutes, the tribunal is almost always composed of three arbitrators.

§ 4:4.7 *How Should the Tribunal Be Chosen?*

The arbitration rules that are analyzed in chapter 3 contain provisions relating to the selection of arbitrators. These rules may be accepted, or the parties may agree in the arbitration clause to a different method of appointment. The rules analyzed, like most arbitration rules, also contain default provisions that come into play when a party has not appointed an arbitrator pursuant to the manner of selection provided for in the arbitration clause or in the governing rules.

When the tribunal is to be a sole arbitrator, the parties may agree on a mode of selection such as having their counsel, after the arbitration has been commenced, choose the arbitrator by agreement. If they cannot agree, the institution—here the ICC, the AAA, or the CPR—would make the appointment. Where the tribunal is to be composed of three arbitrators, a commonly used method of selection is for each party to select an arbitrator and for those two arbitrators to select the third, who will function as the chairman. Many experienced counsel view this method as the most satisfactory one available.

One should also consider what should not be in the selection provisions. First, except in the most unusual circumstances, arbitrators should not be selected until the arbitration has been commenced. If the arbitrators are selected at the time of contracting, they may well be dead or otherwise unavailable when the arbitration is commenced. Second, the arbitration clause should not contain a long list of specific qualifications. Some broad statement of qualifications may be appropriate, but the longer and more detailed the list, the harder it will be to find persons meeting those qualifications. Moreover, when the arbitration is commenced, counsel might want a different profile for arbitrator selection than he would have wanted at the time the arbitration clause was drafted. Finally, it should be kept in mind that the selection of the tribunal is often the single most important event of the arbitration. This will be considered in greater detail in chapter 5.

§ 4:4.8 *Are Interim Measures Likely to Be Required?*

The rules considered in chapter 3 all contain provisions for interim measures.⁶ Such measures may include injunctive relief and measures for the protection or conservation of property and dispositions of perishable goods. Effective interim relief may require application to the courts, a fact recognized by the rules. Depending upon the circumstances, the likelihood of securing effective judicial relief may turn on the venue of the arbitration and/or the location of assets. If interim relief may be needed, the arbitration rules chosen should provide for such relief.

§ 4:5 International Arbitrations

The international arbitrations checklist contains the same elements as the domestic list plus two additions: What will be the language of the arbitration? What is the most desirable venue? The issue of venue is considerably more complicated for international arbitrations than for domestic U.S. arbitrations.

§ 4:5.1 *Language*

The question of the language of the arbitration will arise if the participants in the arbitration—parties, counsel, and witnesses—come from different countries and do not speak a common language. Often the language chosen is the language of the contract containing the arbitration clause. If no language has been chosen, most arbitration rules provide that the tribunal may determine the language based on the circumstances of the arbitration, with particular importance being given to the language of the documents which contain the arbitration clause. Sometimes, more than one language is chosen. If this is done, the arbitration clause should state which language is to be used for the rulings and awards of the tribunal.

If the language of the arbitration is not that of all participants, provisions will of course have to be made for the translation of documents and the testimony of witnesses. Translations are time

6. See ICC Rules, Article 23; AAA Commercial Rules, R-34; AAA International Rules, Article 21; CPR Domestic Rules, Rules 13 and 14; and CPR International Rules, Rules 13 and 14.

consuming. The examination of a witness, for example, may take two or three times longer if an interpreter is required. Translations of documents and interpretations are also costly. These matters are usually resolved by agreement of the parties during the course of the arbitration or by the rulings of the tribunal.

§ 4:5.2 What Should Be the International Venue?

Venue, which is often referred to as “the situs” or “the place” of arbitration, is one of the most significant elements of the arbitration clause in international arbitration.⁷ This is because at least the mandatory provisions of the *lex arbitri*—the law of the place of arbitration—govern the procedural aspects of the arbitration. While it is not unusual to have clauses in an international contract providing that the law of a jurisdiction other than the jurisdiction of the venue will govern the substantive issues of the contract, the parties cannot contract out of the mandatory provisions of the *lex arbitri*. Venue is also important because the legal structure and the courts of the venue provide the jurisprudence and the judicial system that will control controversies over procedure, if these are not finally resolved by the tribunal. Venue may also be important with respect to interim relief and matters relating to the obtaining of evidence.

In addition, it should be kept in mind that the choice of venue (the “seat of” arbitration) may have an effect upon the enforcement of an award. In *C v. D*,⁸ the English Court of Appeal decided in December 2007 that, where there was no express choice of law of the arbitration agreement and the seat of the arbitration was London, the parties to an arbitral agreement must have agreed that English law—rather than New York law, which was the proper law of the contract subject to arbitration—should govern proceedings on the award. Longmore, L.J., held that “by choosing London as the seat of the arbitration, the parties must be taken to have agreed that the proceedings to enforce the award should only be those permitted by English law. On this basis, the court granted an anti-suit injunction preventing the

7. In the United States, the Federal Arbitration Act, which is a federal law applying to all the states, generally controls procedure. This makes venue less important in domestic arbitrations.

8. *C v. D*, [2007] EWCA (Civ) 1282. This is the published approved judgment.

defendants from relying on the law of New York in any application to enforce the award. This eliminated the defense of “manifest disregard,” which was available under New York law but not under English law.

The basic reasoning behind Longmore’s decision can be found in three quotations from his long and somewhat rambling opinion:

22. It is necessary to distinguish between the proper law of the underlying insurance contract which is, by agreement, the internal law of New York and the arbitration agreement which is, by virtue of section 7 of the 1996 Act, as well as by virtue of common law, a separable and separate agreement, see *Harbour Assurance Co (UK) Ltd v Kansa General International Insurance Co Ltd* [1993] QB 701 before the Act and *Premium Nafta Products Ltd. v Fili Shipping Co Ltd* [2007] UKHL 40 after the Act. There is also the law of the seat of the arbitration, namely English law, which will be relevant. The question then arises whether, if there is no express law of the arbitration agreement, the law with which that agreement has its closest and most real connection is the law of the underlying contract or the law of the seat of arbitration. It seems to me that if (contrary to what I have said above) this is a relevant question, the answer is more likely to be the law of the seat of arbitration than the law of the underlying contract.

...

26. It does not seem to me that Lord Mustill is in fact saying any such thing. He is merely saying that although it is exceptional for the proper law of the underlying contract to be different from the proper law of the arbitration agreement, it is less exceptional (or more common) for the proper law of that underlying contract to be different from the *lex fori* or curial law namely the seat of the arbitration. He is not expressing any view on the frequency or otherwise of the law of the arbitration agreement differing from the law of the seat of the arbitration. One is therefore just left with his dictum in *Black-Clawson* (with which I would respectfully agree) that it would be rare for the law of the (separable) arbitration agreement to be different from the law of the seat of the arbitration. The rea-

son is that an agreement to arbitrate will normally have a closer and more real connection with the place where the parties have chosen to arbitrate than with the place of the law of the underlying contract in cases where the parties have deliberately chosen to arbitrate in one place disputes which have arisen under a contract governed by the law of another place.

...

28. As the judge observed in paragraph 45 of his judgment [in *Miller v. Whitworth*], these are only general considerations; much more forceful in the present case are the positive indications in the arbitration agreement itself which point to English law governing the agreement. Moreover as the judge points out in paragraph 47, the provision that the arbitral decision shall be final and binding and

"... a complete defence to any attempted appeal or litigation of such decision in the absence of fraud or collusion"

would be rendered otiose if either party could say in New York that there had been a manifest disregard of New York law. That itself must be a strong pointer to the arbitration agreement being governed by English rather than New York law. . . .⁹

The most important factor to consider in choosing the international venue is whether or not the jurisdiction's legal system is friendly to arbitration or not. The legal system of the United States (in particular the federal system) has for many years been considered a friendly system.¹⁰ The legal system of Great Britain for many years was considered an unfriendly system. This made London an undesirable venue for international arbitration. But legislation passed in 1996, the English Arbitration Act, changed the legal environment, and London is now a favored situs for international arbitrations.

9. *Id.* at ¶¶ 22, 26, 28.

10. See section 2:4 for a description of the Federal Arbitration Act and discussion of the friendly environment that it created.

The principal factors to consider in determining whether the legal system is friendly or unfriendly are these:

1. Enforceability of agreement to arbitrate
2. Interference with proceedings
3. Finality of the award
4. Enforcement of the award
5. Restrictive local requirements limiting a party's choice of counsel or arbitrators

In general, the most favored jurisdictions for international arbitrations appear to be, in alphabetical order, France, Great Britain, Switzerland, and the United States.¹¹ Singapore and Hong Kong are frequently used where an Asian venue is desired.

Moreover, enforcement of the award will probably depend largely on the applicability of the New York Convention of 1958. The venue should *always* be in a country that is signatory to the New York Convention.

§ 4:6 Conclusion

It is generally accepted that proceedings and arbitration hearings are to be conducted by the tribunal as it deems appropriate, subject only to the specific requirements of the applicable rules and the overriding requirement that all parties are given due process, which consists of the right to be heard and a fair opportunity of each to present its case.

If the items listed in the checklists¹² are covered by an arbitration clause, the foundation has been laid for the determination of any disputes by arbitration. In the vast majority of cases, adding bells and whistles to the clause is to be avoided.

11. Based upon statistics of the ICC reporting the venues of arbitrations administered by the Court of International Arbitration.

12. See section 4:3.